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REVENUE RULING 07-002 (May 22, 2007) DEPARTMENT OF REVENUE ANNOUNCES POSITION ON THE INTER-STATE COMMERCE EXCLUSION AFTER *WORD OF LIFE*

By

Jones Walker State and Local Tax Group
William M. Backstrom, Jr.
Louis S. Nunes, III
Jonathan R. Katz
Brandon A. Lagarde
Kathryn S. Friel

In Revenue Ruling 07-002 (May 22, 2007), the Louisiana Department of Revenue explained how it will apply the interstate commerce exclusion from the Louisiana sales and use tax in light of the decision of the Louisiana Supreme Court in *Word of Life Christian Center v. West*, 936 So. 2d 1226 (La. 2006).

In the *Word of Life* case, the Louisiana Supreme Court addressed the application of La. Rev. Stat. Ann. § 47:305E (commonly referred to as "interstate commerce exclusion") to an aircraft that was purchased outside of Louisiana, imported into Louisiana, hangared in Louisiana, and used for interstate flights. The Louisiana Supreme Court overturned two important Court of Appeals decisions[1] and held that although the taxpayer "intended to use" the aircraft in interstate commerce when the aircraft entered Louisiana, the taxpayer was not "using" the aircraft in interstate commerce when the aircraft entered Louisiana, and the interstate commerce exclusion did not apply. The Supreme Court found that when the aircraft entered Louisiana, there was a "taxable moment" in Louisiana before interstate commerce began. The *Word of Life* decision substantially restricts the availability of the interstate commerce exclusion in situations where a taxpayer purchases property outside of Louisiana and imports that property into Louisiana for ultimate use in interstate commerce. Although there may be exemptions that apply in particular circumstances, exemptions are subject to suspension whereas exclusions are not. That is why the interstate commerce exclusion has gained such prominence in Louisiana sales and use tax law.

The Revenue Ruling announces two very important interpretations that taxpayers should be aware of.

- First, the Department substantially restricts their interpretation of what constitutes "interstate commerce."

[1] *See Shaw Group, Inc v. Kennedy*, 1999-1871 (La. App. 1 Cir. 9/22/00) 767 So. 2d 937; *Tigator, Inc. v. West Baton Rouge Police Jury*, 94-1771 (La. App. 1 Cir. 5/5/95) 657 So. 2d 221, *writ denied*, 663 So. 2d 712 (La. 1995) (these two cases collectively held that the intended "ultimate use" of aircrafts or truck trailers in interstate commerce barred the Louisiana use taxation of the property).

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- Second, the Department distinguishes between interstate commerce and "bona fide" interstate commerce.

The Restriction of Interstate Commerce

In the Ruling, the Department states that any aircraft or other transportation property that is based and stored in Louisiana for any length of time is subject to state and local use tax regardless of the use of the aircraft. The Department also states that any aircraft that is hangared in Louisiana and that uses Louisiana as its base of operation will be subject to Louisiana use tax, even though the aircraft has already begun to be used exclusively in interstate commerce. The Department does make a distinction between aircraft that is based in Louisiana and aircraft that is not based in Louisiana but enters Louisiana from an out-of-state origin for the sole purpose of refueling, repair, or letting out or taking on passengers or cargo, which the Department holds is protected from the Louisiana use tax by the interstate commerce exclusion.

The Department's interpretation of interstate commerce is much more restrictive than the Louisiana Supreme Court's interpretation in *Word of Life*. In *Word of Life*, the Court held that the use tax applied because the aircraft entered Louisiana before the aircraft began to be used in interstate commerce. The Louisiana Supreme Court stated that the taxable moment occurred prior to interstate commerce beginning. The Louisiana Supreme Court went on to state that once interstate commerce began, the aircraft was protected from local use taxes by the interstate commerce exclusion. The Department's interpretation is inconsistent with the Louisiana Supreme Court's interpretation with respect to aircraft that has already begun to be used in interstate commerce.

Bona Fide Interstate Commerce

The Department then goes further, distinguishing between interstate commerce and "bona fide" interstate commerce. The Department states that the interstate commerce exclusion only applies if the aircraft or other transportation property is used exclusively in the "exchange of goods and services…involving transportation between cities, states, and nations." The Department further explains:

> [The] interstate exchange of goods and services includes not only the for-hire commercial transportation of passengers or property between states, but also the vendor delivery to customers of property sold or leased; the transportation of inventory, assets to be rented or leased, or other direct revenue-producing property to the locations where the property will be sold, leased, manufactured or fabricated for sale or lease, or deployed for use in the rendering of commercial services; and the transportation of personnel and property across state lines to and from sites where per-

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sonnel and property will be used directly in commercial revenue-producing activities.

The Department notes that the transportation of business owners, officers or employees between states for purposes other than ***direct revenue production*** will not be considered bona fide interstate commerce. However, the Department fails to provide a clear definition of the phrase "direct revenue production." Which leads you to this example:

A corporate taxpayer owns an aircraft that is hangared in Florida and has its base of operations in Florida. The president of one of the taxpayer's best customers loves to be entertained and loves Louisiana. Several times a year, the taxpayer's president brings this client to Louisiana in the aircraft. Would the Department consider this the transportation of employees for direct revenue production? What if the gentlemen never conduct any business in Louisiana? What if no employees of the taxpayer accompany the client to Louisiana? Is the plane being used in Louisiana so that it is subject to the Louisiana use tax? This example illustrates the difficulty in applying this principle. Certainly the taxpayer would consider the use of the aircraft in any of the above situations as bona fide commerce, even though the trips may not directly produce revenue. The Department's analysis suggests that it might not agree.

Prospective Application - Maybe

In the Revenue Ruling, the Department announced that it will apply the *Word of Life* decision on a prospective basis only, beginning with periods that begin after July 1, 2007. However, the taxable period for the use tax is any period (typically any month) during which property is used in Louisiana. Thus, July 1, 2007, begins a new use tax period. What is not made clear in the Ruling, and what is of utmost importance to taxpayers that hangar aircraft in Louisiana, is whether the Department will attempt to assess the use tax on aircraft hangared in Louisiana using the aircraft's fair market value as of July 1, 2007, as the tax base. Taxpayers that have imported aircraft into Louisiana without paying Louisiana state and local use taxes should take this opportunity to review their decisions with respect to hangaring and storing aircraft and other transportation property that is used in interstate commerce. It may be time to fly. If such an aircraft is removed from Louisiana prior to July 1, 2007, and hangared in another state, the Department will not attempt to assess a use tax on the aircraft. Any taxpayer that decides to continue to store such property in Louisiana should maintain and retain accurate records as to the use of the property, *e.g.* detailed flight logs, mileage logs, etc. to support its position that the aircraft is being used exclusively in interstate commerce.

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Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

William M. Backstrom, Jr.
Jones Walker
201 St. Charles Avenue, Suite 5100
New Orleans, LA 70170-5100
Telephone: 504.582.8228
Email: bbackstrom@joneswalker.com

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Backstrom, Jr., William M.
Belter, Sarah B.
Benjamin, Jr., Edward B.
Blackman, IV, John C.
Casey, Robert R.
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